REVIEW & OUTLOOK

Defining Delinquency Down

Government programs to reduce defaults are encouraging more debt.

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ObamaCare may get most of the press, but don't forget the growing mess that is the Obama Administration's student-loan program. We reported last week on the rising costs of the President's income-based repayment plans, but it seems we weren't alarmist enough.

A new report by the Federal Reserve Bank of New York finds that as of the fourth quarter of 2012 only about 40% of student borrowers were paying down their loans. About 17% were delinquent, defined as 90 days past their due payment. Hard to believe, but this "measured delinquency rate" is higher than any other consumer debt product, even credit-card debt.

Yet it is only half of the "effective" delinquency rate. A whopping 14% of borrowers who were not officially delinquent had the same balance as the previous quarter and 30% saw their balances *increase.*

That's because borrowers who can't afford to pay down their loans can ask the government for a deferment or forbearance, which freezes their payments while interest continues to accrue. During a deferment, Uncle Sam pays the interest on subsidized loans. To qualify for either option, borrowers merely need to claim an economic hardship or return to school. Borrowers can postpone payments indefinitely by enrolling in college half-time—during which time they can take out even more loans. Borrowers can use the loans to pay for incidental living expenses.

Heavily indebted borrowers can also enroll in an income-based repayment plan, which caps monthly payments at 10% of their discretionary income—about $150 per month for someone earning $30,000 annually. The government then forgives the entire outstanding loan after 10 years of making these minimum payments while working for a nonprofit or the government. You have to wait 20 years if you work in the profit-making economy.

But as the New York Fed report notes, borrowers who participate in income-based repayment plans may "make only small payments, which are often insufficient to cover the accumulated interest." Thus their loan balances grow.

Student loan debt nearly tripled to $966 billion in 2012 from $364 billion in 2004, but not merely because more students are going to school and taking out bigger loans. The Fed report's major finding is that government programs intended to prevent defaults are actually causing many borrowers to rack up more debt. Yet these borrowers aren't included in the government's official default or delinquency rates.

This reduces the political pressure to rein in government student lending, even though on present trend taxpayers will have to absorb tens of billions in default losses. As withObamaCare, Mr. Obama passes out the loan benefits to young voters now, but everyone pays the price later.